MINUTES OF THE BOARD FINANCE & ADMINISTRATION COMMITTEE MEETING
CHEMEKETA EOLA NORTHWEST VITICULTURE CENTER
SALEM, OREGON
MAY 4, 2007

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MINUTES OF THE BOARD FINANCE & ADMINISTRATION COMMITTEE MEETING
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MINUTES

1. CALL TO ORDER/ROLL CALL/WELCOME

Chair Don Blair called the meeting to order at 8:10 a.m. Committee members present included: Chair Don Blair and Directors Gerry Blakney (arrived at 8:20 a.m.), Kirby Dyess, Henry Lorenzen, and Tony Van Vliet. Director John von Schlegell was absent due to a business conflict. Other Board members present: Directors Adriana Mendoza (arrived at 8:35) and Dalton Miller-Jones (arrived at 8:25 a.m.).

Chancellor’s Office staff members present included: Chancellor George Pernsteiner, Michael Green, Ryan Hagemann, Jay Kenton, Ben Rawlins, Diane Saunders, Patricia Snopkowski, Marcia Stuart, and Susan Weeks.

Campus representatives included: presidents Mary Cullinan (SOU), Khosrow Fatemi (EOU), John Minahan (WOU), and Ed Ray (OSU); and vice presidents Lindsay Desrochers (PSU), Frances Dyke (UO), and Bob Nettles (OIT).

2. ACTION ITEMS

a. Report on Investments – As of March 31, 2007

BOARD DOCKET:

The investment report for the third quarter of Fiscal Year 2007 is available at http://www.ous.edu/state_board/meeting/index.php. The following is a brief summary of the information contained in the report.

As of March 31, 2007, total OUS investments had a combined market value of $304 million, summarized as follows:

<table>
<thead>
<tr>
<th>Fund</th>
<th>Market Value March 31, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endowment Funds (pooled and separately invested)</td>
<td>$80,375,903</td>
</tr>
<tr>
<td>Donation Funds</td>
<td>56,433,975</td>
</tr>
<tr>
<td>Fund</td>
<td>Market Value March 31, 2007</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td>Bond Building Funds</td>
<td>75,445,911</td>
</tr>
<tr>
<td>Bond Sinking Funds</td>
<td>62,319,550</td>
</tr>
<tr>
<td>Auxiliary Enterprise Building Repair and Equipment Replacement Reserves</td>
<td>28,987,704</td>
</tr>
<tr>
<td>Total</td>
<td>$303,563,043</td>
</tr>
</tbody>
</table>

Oregon State Treasury Analysis - Quarter Ended March 31, 2007:
As background, global financial markets finished the quarter on a positive note, following a sharp decline towards the end of February, which many financial analysts attributed to China. However, by the end of March, all the major indices (save the DOW) were positive for the quarter. Small cap growth companies led the way domestically, posting an index return of 2.5 percent, while developed international markets, as represented by the MSCI EAFE Index, did even better, posting a quarterly return just north of 4 percent. The Lehman Brothers Aggregate Bond Index ended flat for the month of March, posting a 1.5 percent return for the quarter.

For the quarter ended March 30, 2007, the Higher Education Pooled Endowment Fund (HIED) returned 2.73 percent, exceeding the policy benchmark by 59 basis points. Over more meaningful time periods, the fund has exceeded its policy benchmark by 76 basis points and 123 basis points (for the three- and five-year periods, respectively, ended March 30, 2007). On a net of fees basis, HIED has generated an average annual return of 9.04 percent for the five years ended March 30, 2007.

For the quarter, the BGI Alpha Tilts large-cap component of the fund underperformed the S&P 500 benchmark by 69 basis points by returning a negative .05 percent. However, over more meaningful time periods, this strategy has served HIED well. In the international equity space, Arrowstreet Capital turned in an incredible quarter of 5.95 percent, which exceeded the MSCI World Ex-US Index by 186 basis points. This helped fuel a one-year performance number of 21 percent versus 20.1 percent for the benchmark. In the final piece of the public equity portion of the fund, the mid-cap fund, managed by Batterymarch, turned in a very solid quarter, on the heels of two quarters of underperformance. The Batterymarch portfolio returned 5.38 percent for the quarter, which was 183 basis points better than the Russell 2500 Index. While still negative over the one and three-year periods, we are not concerned with the volatility of this manager, given their longer-term ability to outperform, as evidenced by their five-year 13.68 percent return, versus 12.14 percent for their benchmark.

While Western Asset Management slightly underperformed its Lehman Aggregate benchmark for the quarter, the longer-term performance for this account remains exceptional.

Lastly, the total amount contributed to HRJ Capital, in the private equity large-buyout space, approached $1.6 million of a $5 million total commitment. Returns are far too early in the investment cycle to be considered at this time.
**Donation and Other Investable Funds:**
Donation, bond building, bond sinking, and repair and replacement reserve funds are invested in the Oregon State Treasury Short-Term Fund and returned 1.3 percent for the quarter, which tracked the 91 Day T-Bill rate of 1.3 percent.

**Staff Recommendation to the Committee:**
Staff recommended the Committee accept the Investment Report as of March 31, 2007.

**COMMITTEE DISCUSSION AND ACTION**
Controller Michael Green summarized the Report on Investments for the quarter ended Marcy 31, 2007. Mr. Green noted that the total pooled endowment fund returned 2.7 percent, or 60 basis points, above its allocation policy benchmark. The allocation to large cap equity Alpha Tilts fund returned a negative 0.1 percent for the quarter, or 70 basis points below its target. "However," he noted, "over both a three-and five-year basis, that fund has beaten its benchmark by 90 basis points on a three-year basis and 100 basis points on a five-year."

The allocation to Batterymarch, a small mid-cap allocation, returned 180 basis points above its benchmark quarter which was good news, as it has been showing negative returns or under benchmark returns. The foreign equity allocation, Arrowstreet Capital allocation, had a solid quarter and returned 190 basis points above the benchmark.

All other funds that are investable and currently earning interest to the System are in the treasury short term fund and earning 1.3 percent for the quarter.

Chair Blair noted that it was a “solid” investment quarter for the System, thanked the Controller and asked for a motion to accept the report. Director Van Vliet moved the motion to accept the Report on Investment; those voting in favor included Directors Don Blair, Gerry Blakney, Kirby Dyess, Henry Lorenzen, and Tony Van Vliet. The motion carried.

b. **Managerial Reporting – Quarterly Management Report**

**BOARD DOCKET:**

The quarterly management reports as of March 31, 2007, are available at [http://www.ous.edu/state_board/meeting/index.php](http://www.ous.edu/state_board/meeting/index.php). After reviewing the Budget Projections Summary received from each university and comparing prior year results, the following items were noted:

**Education and General – Limited:** Revenue collections are projected to be up 4.6 percent above 2005-06 due to equal increases in both tuition and state funding. Revenue collections year-to-date are up 7.7 percent over the prior year due to the receipt of the additional compensation funding from the state in the first quarter of 2006-07 and increases in tuition. Spending is up 2.4 percent year-to-date above the prior year and is projected to be 4.1 percent above 2005-06 at year-end. The increase in spending is primarily due to pay raises and increased benefit costs.
The ending fund balance of Education and General–Limited is projected to decrease to 9.7 percent of operating revenues compared to 10.9 percent at the end of the prior year and 13.0 percent at the end 2004-05, an average annual decline of approximately 14 percent. Although the Systemwide fund balance has sustained a steady decline in recent years, the projected June 30, 2007, fund balance of Education and General–Limited is within the Board directed reserve level of 5–15 percent.

Consistent with first quarter projections, all institutions are projecting a decline in ending fund balance as a percent of operating revenues. SOU’s fund balance is projected to be 2.3 percent, below the Board’s recommended lower threshold of 5 percent. The following institutions are projected to be below the Board recommended 10 percent level: EOU – 5.0 percent; OSU – 8.5 percent; and SOU – 2.3 percent.

The Chancellor’s Office ending fund balance exceeds the recommended reserve level of 5–15 percent of operating revenues. The current year plan projects a 45 percent spend down of the Chancellor’s Office fund balance.

**Auxiliary Enterprises:** Auxiliary Enterprises are projected to have a $1.2 million decrease in unrestricted net assets compared to the Adjusted Budget increase of $1.0 million. Auxiliary Enterprises’ unrestricted net assets are projected to be $56.9 million, a 3.8 percent decrease from the Adjusted Budget. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.

**Designated Operations, Service Departments, and Clearing Funds:** The ending fund balance is projected to be $26.3 million and $2.4 million below the Adjusted Budget. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.

**Staff Recommendation to the Committee:**
Staff recommended that the Committee accept the Budget Projections Summary for March 31, 2007.

**COMMITTEE DISCUSSION AND ACTION:**

Controller Green briefed the Committee on the quarterly management report as of March 31, 2007. He reminded the Committee that in the prior year, before the General Accounting Standards Board (GASB) 35 was implemented, it was generally accepted accounting principles for colleges and universities to record the summer session revenues and expenditures into the fiscal year in which the session was predominantly operating. However, since the advent of GASB 35, the practice has changed to an accrual basis approach, wherein the activity is to be recorded in the fiscal year in which it occurred, regardless of the year in which it predominantly operates. The result will be that, in the current fiscal year, an adjustment for each campus will be reflected to bring the accounting into compliance with the new standards. During the discussion, Director Blair noted that the impact on the fund balance would be relatively modest.
Following is a summary of Controller Green's report on each institution.

**Eastern Oregon University** has experienced a decline in enrollment that will result in 1.7 percent lower total revenues and transfers than projected. At the time of the report, EOU projected a decrease in full-time enrollment of 6.5 percent from projections. After the submission of the report from EOU, detailed analysis of Eastern's transfers highlighted that projected net transfers in will be about $50,000 lower than what was reflected in the report in the docket. “We will move the ending fund balance down below the 5 percent Board's policy target,” Green reported. “We've seen tuition and fee revenues down by about $936,000 over the target. I think it would be a good idea to update the three-year plan that was submitted to the Board last year,” he offered.

Chair Blair concurred and asked President Fatemi if it would be feasible to do that. President Fatemi responded that he could re-do the plan, but that some of the referenced variance was due to the adjustment that Controller Green had mentioned regarding summer enrollment accounting. When questioned about the fall enrollment, which was down by about 4.5 percent, winter enrollment up a few percentage points, and then spring term down by 8.4 percent, which is almost twice as much as the fall enrollment number the President responded: “We've done some preliminary analysis and most of the decline in the fall is in distance education, which is a bigger surprise than the fact that our enrollment numbers are down.; he explained. “Over the past several years, distance education has been going up and the campus numbers have been pretty much steady. Unless there is some problem with the numbers, that is a huge and very unexpected drop, and I can't explain why at this point.”

It was made clear that the Board needed to understand the tuition trends to enable financial contingency planning. “Because of the time required to make adjustments in the financial model, you need lead time to do that and the next fiscal year is going to be starting very soon. If you are going to have a chance to change the trend line, financially, we will have to move quickly,” Chair Blair explained. President Fatemi agreed that he would report back to the Board in June.

**Oregon Institute of Technology's** projected Education and General revenue and expenditures were in line with their first quarter projections; the ending fund balance was projected to be 11.5 percent compared to the adjusted budget of 10.9 percent. All of the figures were in line with prior projections. Chair Blair commended OIT for a great job in managing the financial aspect of the institution.

**Oregon State University's** total revenues and transfers in were projected to be $1.4 million or 0.4 percent higher than the adjusted budget. OSU was projecting an ending fund balance of 8.5 percent, which was consistent with the adjusted budget. The year-to-date realization rate for other revenue was lower than the prior year, primarily due to the timing of the recognition of indirect cost recoveries and the timing of the receipt of federal and county appropriations related to OSU statewide public services. Chair Blair questioned a $2.5 million under-spending in personnel services and a $3 million over-spending in supplies and services against the adjusted budget. President Ray explained that the under-spending on the personnel side was
from unfilled positions. “Part of it is the competitive pressures we face. I think a number of units, not inappropriately, are holding back on positions that in better times they would work very aggressively to fill. I think there has been a somewhat conservative recruiting process going on in terms of personnel,” he observed.

Continuing the OSU review, Chair Blair asked if there was a problem in auxiliaries. President Ray said that, in part, there is a lowering of expectations in terms of forecasts for revenues associated with conferences and meetings. “There have been some changes in conferences and meetings, some of it associated with external groups not coming and some of it related to internal groups just simply not having as many meetings and forums as they may have had in the past. Again, this is because people are looking for places to tighten their belts.” In terms of athletics, OSU is pushing toward having them be totally self-supporting. The amount of support from OSU to athletics has dropped from $4 million to $2.5 million and the athletic director knows that he is expected to continue to push toward zero, the president explained.

Portland State University's total revenues and transfers in were projected to be $194 million, which was $1.2 million (or 0.6 percent) higher than the adjusted budget. Total expenditures and transfers-out were projected to be $193 million, which was approximately $3.7 million (or 1.9 percent) lower than the adjusted budget. The decrease is primarily due to unfilled positions, lower than anticipated utility rate increases, and lower building rental and lease expenses. PSU's ending fund balance was projected to be 11.3 percent compared to the adjusted budget of 8.8 percent. On balance, the PSU report was positive and Chair Blair congratulated them.

Southern Oregon University's Education and General Funds, total revenues, and transfers-in were projected to decrease $992.00 or 2.5 percent from the adjusted budget. This was primarily due to a decrease in enrollment and decreased revenue from nonresident students. Year-to-date realization rates for tuition, fees, and other revenue were consistent with the prior year, as was the burn rate for personnel services. SOU's ending fund balance was projected to be 2.3 percent of operating revenues compared to the adjusted budget projection of 3.2 percent. Chair Blair observed that SOU needs to be closely watched. “At 2.3 percent ending fund balance, we're very, very close to the edge.” President Cullinan indicated that SOU is going to manage spending. “I think the 2.3 percent ending balance is pretty conservative,” she shared. “I think by the end of the year we should be closer to the 3.2 percent. But we're going to have to manage it in the next few months.” SOU projected an ending fund balance of approximately 3 percent.

Director Van Vliet inquired if SOU expended funds on Jefferson Public Radio. President Cullinan indicated that it supports 1.5 positions. “But they also bring money back to us. It is a very insignificant amount that we put into the operation for what we get back,” she concluded.

The University of Oregon's total revenues and transfers in for Education and General were projected to be $1.8 million or 0.7 percent higher than the adjusted budget. This was primarily due to higher than anticipated non-resident undergraduate enrollment. Total expenditures and transfers-out were also projected to decrease $1.8 million, primarily due to lower than anticipated unclassified faculty salaries and PEBB costs. The ending fund balance was projected
to be 10 percent of operating revenues compared with the adjusted budget amount of 8.6 percent and prior year ending fund balance of 11.4 percent.

Western Oregon University projected total revenues and transfers in to be $913,000 or 2.4 percent lower than the adjusted budget. The decrease was primarily due to lower than anticipated enrollment and a decrease in revenue from nonresident students. Total expenditures and transfers-out were projected to decrease $1.5 million or 3.8 percent from the adjusted budget, due to continued implementation of reduced spending measures such as deferment of hiring to fill vacancies and restructuring classes with full enrollment. The ending fund balance was projected to be 10.3 percent of operating revenues compared to the adjusted budget projection of 8.6 percent and prior year-ending fund balance of 11.1 percent. Chair Blair congratulated WOU, indicating that the report was a positive one.

For the Chancellor’s Office, the general revenues and transfers-in were projected to increase $1.6 million from the adjusted budget, primarily due to a transfer in resulting from the review of inactive agency funds. Total expenditures and transfers out were projected to increase $5 million from the projected budget, primarily due to a $3 million transfer to PSU for the acquisition of office space. The ending fund balance was projected to be 31.1 percent of revenues compared to the adjusted budget project of 55.8 percent.

Director Lorenzen moved and Director Van Vliet seconded the motion to accept the Quarterly Management Report as presented. Those voting in favor: Directors Blair, Blakney, Dyess, Lorenzen, and Van Vliet. Those voting no or abstaining: none. Motion passed.

c. Chancellor’s Office Fund Balance

BOARD DOCKET:

Background:
In November 2004, the Board authorized the Chancellor to approve commitments of the Chancellor’s Office fund balance up to $250,000 per item and up to an annual aggregate of $1 million, with delegation of authority to the Finance and Administration Committee to approve items in excess of these amounts.

The following is a report on the uses of fund balance for 2006-07 that had been updated to reflect the latest financial projections that appear in the Management Report for the third quarter.
<table>
<thead>
<tr>
<th>Description</th>
<th>FY 07 YTD Expense (thru 3/31/07)</th>
<th>Remaining Expense</th>
<th>Total Projected Cost (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chancellor's Office Space in PSU PCAT Bldg Phase 1 (2)</td>
<td>(202,530)</td>
<td>-</td>
<td>(3,000,000)</td>
</tr>
<tr>
<td>Oregon Bio-Economy and Sustainable Technologies (2)(4)</td>
<td>(479,437)</td>
<td>-</td>
<td>(1,000,000)</td>
</tr>
<tr>
<td>ATLAS project (software articulation system) (2)</td>
<td>(479,437)</td>
<td>-</td>
<td>(681,967)</td>
</tr>
<tr>
<td>IDTS contract work delayed from FY 06 (3)</td>
<td>(630,637)</td>
<td>-</td>
<td>(630,637)</td>
</tr>
<tr>
<td>Capital Center - CO subsidy for unrented space</td>
<td>(587,000)</td>
<td>-</td>
<td>(587,000)</td>
</tr>
<tr>
<td>TDI program revisions and outsourcing (2)</td>
<td>(145,411)</td>
<td>-</td>
<td>(467,282)</td>
</tr>
<tr>
<td>Database Integration-5th Site (2)</td>
<td>(400,000)</td>
<td>-</td>
<td>(400,000)</td>
</tr>
<tr>
<td>Other misc. uses (printing, office renovation, consulting, etc.)</td>
<td>(145,411)</td>
<td>-</td>
<td>(310,178)</td>
</tr>
<tr>
<td>Disaster recovery/business continuity planning</td>
<td>(300,000)</td>
<td>-</td>
<td>(300,000)</td>
</tr>
<tr>
<td>Board initiatives</td>
<td>(155,395)</td>
<td>-</td>
<td>(291,758)</td>
</tr>
<tr>
<td>OHSU/PSU merger study</td>
<td>(79,251)</td>
<td>-</td>
<td>(158,502)</td>
</tr>
<tr>
<td>Sustainability initiative</td>
<td>(81,625)</td>
<td>-</td>
<td>(130,750)</td>
</tr>
<tr>
<td>OMI industry match payment delayed from FY 06</td>
<td>(145,411)</td>
<td>-</td>
<td>(106,719)</td>
</tr>
<tr>
<td>WOU Police Academy debt service</td>
<td>(145,411)</td>
<td>-</td>
<td>(106,643)</td>
</tr>
<tr>
<td>ETIC payment to UO IGERT (approved by ETIC Board Nov 05)</td>
<td>(45,000)</td>
<td>-</td>
<td>(82,854)</td>
</tr>
<tr>
<td>Executive compensation studies</td>
<td>(45,000)</td>
<td>-</td>
<td>(52,829)</td>
</tr>
<tr>
<td>Institute for Science Engineering &amp; Public Policy (ISEPP) (2)</td>
<td>(45,000)</td>
<td>-</td>
<td>(50,000)</td>
</tr>
<tr>
<td>PEBB analysis (2)</td>
<td>(21)</td>
<td>-</td>
<td>(40,400)</td>
</tr>
<tr>
<td>Risk management analysis (2)</td>
<td>(20,000)</td>
<td>-</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Federal Office for Federal Policy Advisor (2)</td>
<td>-</td>
<td>-</td>
<td>(20,000)</td>
</tr>
<tr>
<td>FCC license changes (2)</td>
<td>-</td>
<td>-</td>
<td>(16,800)</td>
</tr>
<tr>
<td>SB 437 Review (required by legislature)</td>
<td>(233)</td>
<td>-</td>
<td>(14,700)</td>
</tr>
<tr>
<td>Oregon Campus Compacts</td>
<td>-</td>
<td>-</td>
<td>(10,000)</td>
</tr>
<tr>
<td>PERS analysis (2)</td>
<td>-</td>
<td>-</td>
<td>(6,532)</td>
</tr>
<tr>
<td>Total Commitments of Chancellor's Office Fund Balance</td>
<td>(7,263,369)</td>
<td>(1,272,183)</td>
<td>(8,535,552)</td>
</tr>
</tbody>
</table>

Estimated Commitments of Fund Balance to be processed in subsequent fiscal years: 2,217,475

Additions to Fund Balance

<table>
<thead>
<tr>
<th>Description</th>
<th>Total Additions to Chancellor's Office Fund Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer in (5)</td>
<td>1,865,521</td>
</tr>
<tr>
<td>Current year other operating efficiencies (6)</td>
<td>1,060,357</td>
</tr>
<tr>
<td></td>
<td>2,925,878</td>
</tr>
</tbody>
</table>

Use of Fund Balance

<table>
<thead>
<tr>
<th>Description</th>
<th>Use of Fund Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Fund Balance</td>
<td>(3,392,199)</td>
</tr>
<tr>
<td>Projected Ending Fund Balance at 6/30/07</td>
<td>5,371,784</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fund Balance Breakdown:</th>
<th>Projected Ending Fund Balance at 6/30/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>CO Reserve</td>
<td>4,928,224</td>
</tr>
<tr>
<td>Industry Affairs / OMI</td>
<td>420,000</td>
</tr>
<tr>
<td>IDTS (3)</td>
<td>-</td>
</tr>
<tr>
<td>ETIC</td>
<td>23,560</td>
</tr>
<tr>
<td></td>
<td>5,371,784</td>
</tr>
</tbody>
</table>

(1) Represents either total project cost or remaining project cost from previous year, where applicable
(2) Use of fund balance was previously approved by the Board
(3) $200K of IDTS project will revert to State GF to be rebudgeted in FY 08
(4) Board approved $270K start-up funding; remaining commitment pending supplemental report
(5) Resulted from internal review of inactive funds
(6) Results from estimated salary savings, Capital Center admin fee, and unallocated portion of operating budget
**Staff Recommendation to the Committee:**
Staff recommended that the Committee accept the report and approve the uses of Chancellor’s Office fund balance as itemized in this report.

**COMMITTEE DISCUSSION AND ACTION:**

When the Finance and Administration Committee adopted the charter, the use Chancellor’s Office fund balances over $250,000 required Board approval, Vice Chancellor Kenton pointed out. Additionally, the Committee asked for an annual report. The report provided at this meeting summarized all the known commitments of fund balance at the present time, with one exception. “That would be for Southern Oregon University, either the write-down of the loan or the transition funding that has been discussed at prior meetings,” he explained. Chair Blair commented, “Our ability to replenish this pool of resources is extraordinarily limited. So, we obviously take very seriously what we commit these funds to. I think you’ve done a good job of raising issues that are on strategy for what the Board has articulated and being very tough-minded about what we spend this money on,” he concluded.

Director Van Vliet moved and Director Dyess seconded the motion to accept the report and approve the uses of Chancellor's Office fund balance as itemized in the report. Those voting in favor: Directors Blair, Blakney, Dyess, Lorenzen, and Van Vliet. Those voting no or abstaining: none. Motion carried.

### 3. REPORT ITEMS

#### a. OUS Internal Audit Progress Report

**BOARD DOCKET:**

**Background:**
As outlined in the Oregon State Board of Higher Education Audit Charter, the Oregon State Board of Higher Education (the Board) has oversight responsibility to ensure that Oregon University System (OUS) management is performing its duties of financial reporting, ensuring effective and efficient internal controls, and complying with laws, regulations, and ethics. This report provided information regarding the following audit charter provisions:

- The Board shall review, at least semi-annually, the results of Internal Audit recommendations and follow-up procedures. More frequent meetings will be held as deemed necessary.
- The Board shall have and exercise all other powers, as it shall deem necessary, for the performance of its duties.
- The Oregon State Board of Higher Education has delegated these audit duties to the Finance and Administration Committee. The Finance and Administration Committee shall report the results of internal and external audit findings to the full Board at least once a year.
Quarterly Report Update – Audits issued from February 2007 through April 2007:

During the period from February through April 2007, the Internal Audit Division (IAD) completed one management request engagement and two information technology projects related to departmental information system inventories and security over student grades.

In addition, the results of two scheduled projects and Systemwide follow-up audits were summarized in the following tables.

Scheduled Audit Status

<table>
<thead>
<tr>
<th>AUDIT PROJECT TITLE</th>
<th>INSTITUTION</th>
<th>Risk Rating (as of 4/20/07)</th>
<th>Management Action Addresses Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leave Reporting and Performance Evaluation Processes</td>
<td>Summary</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>UO</td>
<td>Medium</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>OSU</td>
<td>Medium</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>PSU</td>
<td>Medium</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>OIT</td>
<td>Low</td>
<td>Yes</td>
</tr>
<tr>
<td>Procurement Card Program</td>
<td>OUS</td>
<td>Medium</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>SOU</td>
<td>Medium</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>OIT</td>
<td>Medium</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Ratings – The rating relates to the selected financial, compliance, and operational areas tested. The rating is NOT a global performance rating. The rating corresponds to the level of management priority.

High – Some controls exist, but they are generally not functioning as intended and additional controls are needed.

Medium – Controls exist, but some controls are not functioning and/or additional controls are needed.

Low – Controls are in place and functioning effectively. Additional control enhancements are outlined in the recommendation section of the report.

Follow-up Audit Status:

Management has represented that actions will be taken to adequately address all open recommendations. The audit tables representing the implementation status of audit recommendations issued before December 31, 2006, are available at: http://www.ous.edu/state_board/meeting/dockets/ddoc070504.pdf.

COMMITTEE DISCUSSION:

OUS Internal Audit Director, Patti Snopkowski, provided a brief overview of the mission of the Audit Division. The report showed that over the past quarter, Internal Audit issued reports related to information technology as well as completed a management special request, one
related to leave and performance evaluations, and a Systemwide procurement card program review.

Audit worked with the university Chief Information Officers to do a departmental information system survey across the System at each of the campuses. The goal was to raise awareness at the department levels of current security policies that are on the web. In addition, it was to have an inventory and a better understanding of what is actually there for future security reviews and for creating efficiencies and potentially deleting some duplicate databases.

The other information technology engagement related to student grade records. Recommendations will be used to enhance security over student grades, since most of the student grades are currently being done electronically using the inner web.

Another audit was a special management request that originated from a vice president for finance and administration. There were concerns related to the level of documentation on payroll charges on particular restricted funds. Internal Audit noted that work had been performed for the charges. However, there was a lack of adequate documentation to support the justification of these charges to a restricted fund. The campus is going to review the charges and assure they are adequately documented for the use of restricted funds.

The scheduled audits completed this quarter were related to leave, performance, and procurement cards, all of which contain management responses outlining that the risks are being mitigated by actions. One of the factors that triggered the audit of performance evaluations was the emphasis on performance evaluations related to promotion and retention of competent employees in OUS as well as the liability associated with uncompensated leave balances, or vacation payouts, for employees. As a result of this audit, several reports were issued and the recommendations for improvement were insuring supervisory approvals occur for leave taken by employees. Internal Audit also recommended, and is working with the HR directors, to create exception-based reports to monitor leave anomalies, as well as inappropriate segregation and time entry. “Internal Audit also recommends clarification of policies on reporting leave, given the different types of positions,” Ms. Snopkowski reported. “We did note that all of our campuses do use a manual system for recording leave that is relatively antiquated in today's times.”

The procurement card audit was a Systemwide examination of the procurement card system and program. One reason for examining this area was the inherent risks of using procurement cards. A goal of the audit was to evaluate the controls over the program to maximize the utilization of the program by efficiencies and to reduce the liability associated with inappropriate charges. In conjunction with the audit, Internal Audit staff conducted half-day internal control training sessions. A sample of high-risk transactions was reviewed and no fraudulent use was found. It was noted that two campuses have hosting, gift, and office retreat expenses charged that were not in accordance with OUS fiscal policy. These are being corrected on those campuses.
From a Systemwide perspective, Internal Audit made three recommendations. One was ensuring that training is provided to all users of the card, as well as departmental administrators responsible for reviewing the monthly statements. Secondly, it was recommended that administrative controls over program administration be enhanced. And, thirdly, improving detective controls relative to the monitoring. Implementation of these recommendations will likely involve a large programmatic change and may result in a change in the contract with the current provider.

In discussion, it was noted that there are some challenges presented in the program design relative to control gaps. Controller Green observed that it is important to be upfront about the risk assessment of the program and design it based on that assessment. “But we have a real challenge because we have administrative structures that are thin on our campuses. Administering a program this size and expanding the program in certain ways may be difficult to manage. We have to take that into consideration in how we design it,” he concluded.

Director Blair inquired if Internal Audit collected statistics on the rating trends around their audits. “We do have that in our database and one of the ways we use it is to analyze our ratings and the risks when we do our annual risk assessment. We have that information and we have reports on it,” Snopkowski added. Blair indicated that at some point he would like to see how the ratings are trending with the highs, mediums, and lows. “What I’m trying to get a handle on is my subjective point of view that we are getting better at understanding where our control gaps are and addressing them. But I want to also see if these ratings are telling us anything,” he added.

Another point made by Chair Blair was that the presidents and vice presidents of finance and administration have to be continuously assessing what the tradeoffs are regarding staffing and training levels. “The tendency is to generically say, ‘well, I don't have the staffing to do that’ and then not assess the risk that is being created in the organization—for example, procurement cards. This is basically cash. So the lack of control around this, if there is a lack of control in this particular place, can create financial exposure as well as political exposure in the sense that this is very visible and everyone can understand if we have a problem,” he concluded.

Director Dyess asked what the range of risk was in dollar amounts attached to the credit cards and leave balances. Ms. Snopkowski responded that there were $5,000 limits on the cards and there are 1,000 or more cards issued. In the compensated leave balances, there is $37 million – so there are millions of dollars in the two programs being examined.

In terms of follow-up of audits, Ms. Snopkowski noted that there was 100 percent compliance at OIT and WOU on all recommendations. There are open recommendations related to fully implementing the revised conflict of interest policy at the UO, PSU, and OSU. The policies are going to be changed to conform to best practices and will be implemented in the upcoming fiscal year. It will require annual disclosures regardless of whether or not there is a conflict of interest. “I met with the Research Counsel and talked about compliances as a whole. They do have this on their radar and it may be an item that the Board will want to follow-up with the Counsel as part of its routine progress meetings,” Ms. Snopkowski recommended.
Another audit at the UO had open recommendations related to the post award function. “The University has actually completely reorganized the post award function and has created a dual reporting relationship to the business office. This is basically the group that produced financial reports and the appropriateness of transactions. The reorganization has taken place and they are going to have a new director.” Chair Blair asked if it were true that the original audit had been done in March 2006. The answer was yes; continuing, Chair Blair asked if there was reason to believe the audit would be completed now, a year later. Vice President Dyke responded that it took longer than anticipated to hire the right person and reorganize the office. Now the issue would be addressed.

Chair Blair acknowledged that not all irregularities would be identified. “The follow-up process, I think, is one of the most important things we do here. Otherwise, some of the audit work we do is wasted if we’re really not closing the loop. One of the things we have to do, as a System, is recognize we can’t close all the gaps. Let’s at least fix the ones we know about. I realize there are some extenuating circumstances. But it just seems that after a year, we should have had these things closed,” he admonished.

Finally, Ms. Snopkowski discussed some changes in the external auditing standards that will impact OUS in the upcoming year. Auditing standards are changing for this fiscal year ending June 30, 2007. “AICPA adopted new internal control assessment standards in 2006. The General Accountability Office that issued the new internal control assessment standards fully rolled out theirs in February 2007. There are going to be more stringent internal control reporting standards that will be highlighted in our reports in the event weaknesses are noted. The standard doesn’t require additional audit work. However, if the auditors come across what are called ‘indicators of weaknesses,’ they will have to do more testing and the report of those weaknesses will be more formally disclosed in our financial statement packet,” she explained. The Controller’s Division and Internal Audit have been working with the campuses to assure they understand the changes related to the internal control standards.

4. **DISCUSSION ITEM**

a. OUS Cash Investment and Debt Management Proposed Policies

**BOARD DOCKET:**

**NEW TREASURY STRATEGIES**

Universities across the country are finding creative ways to improve their treasury function. With declining state revenues appropriated to public colleges and universities, the level of operating assets that are needed to hedge the volatility in a more tuition-dependent environment has been increasing. Universities are also beginning to pool operating assets for investment purposes to decrease the volatility of operating cash flows. With these increasing levels of operating assets, and the decreased volatility that accrues through pooling, the opportunities for expanding the investment practices applied to these assets (with an
appropriate risk-return profile) have become more attractive and, conversely, the opportunity cost of not taking a different approach to the investment of these funds is increasing.

Additionally, universities are looking at long-term debt management more from a portfolio perspective. The traditional approach to long-term debt management, where fixed-rate securities are issued and the debt service related to proceeds allocated to specific projects is tied to the underlying debt, is giving way to a portfolio approach to debt management. With a portfolio approach, the terms of long-term debt and the timing of issuance can be negotiated from a more strategic process, taking into consideration the current capital markets. True variable rate debt can be introduced and maintained at an appropriate level to lower overall cost of capital and its debt service volatility can be mitigated through both a blended rate and through the volatility of returns on operating assets. The amortization schedule relating to allocations of proceeds can be more flexible (unbound by the underlying debt issuance), based on blended rates (needed to hedge the volatility of variable rate debt), and different time frames for repayment.

Bringing the pooled approach to investing operating assets together with the portfolio approach to managing long-term debt allows tighter asset/liability matching and greater efficiencies in accessing the capital markets, both from the investment and long-term debt perspectives. With the possibility of retaining interest earnings on its operating funds, and with the potential of greater flexibility in long-term debt structures, the System can become more strategic in its treasury management practices. Investment of operating cash flows and issuances of long-term debt can be managed more effectively if these decisions are decoupled from some of the traditional operational processes and constraints that lead, in some cases, to less optimal decisions when looking through a strategic lens.

It is with this as a backdrop that we are proposing that the System change its central treasury function to begin to pool and strategically invest the System’s operating assets and manage its long-term debt in a portfolio approach.

**INVESTMENT OF OPERATING ASSETS**

Currently, investment decisions relating to certain funds, such as the building and equipment reserves of the auxiliary enterprise funds, are based on the expected cash flows of each university’s balances within those funds alone, retaining liquidity within that fund necessary to meet the institution’s specific cash flow demands. The same is true of unrestricted gift funds, bond proceeds, bond sinking funds, and agency funds. If we were to combine these cash balances and these cash flows, along with the tuition and fees, appropriation, and other income cash balances and flows, volatility can be minimized, liquidity can be kept at a minimum, and investments can be made more strategically, looking at the overall risk profile of the pool rather than the operational cash flow needs at a granular basis. Analysis shows that significant incremental returns can be gained through this practice.

The objectives of this structure are to:

- Pool operating assets to decrease cash flow volatility and overall liquidity.
- Manage the investment of operating assets from an overall risk basis, rather than a
security-type approach.
- Maximize return on operating assets within a prudent risk/return profile.
- Increase net assets of the System.

Pooled operating asset investment procedures would be as follows:
- Treasury Office analyzes operating asset flows and, based on historic and projected cash flows, stratifies the balances into three categories:
  - Liquid - invested in short-term, liquid, low-risk assets;
  - Contingent - invested in medium term assets that are somewhat less liquid; and
  - Core - invested in longer term (1-5 year) assets that are less liquid than either the Liquid or Contingent asset “classes.”
- Liquid assets would likely be maintained in the separate checking accounts of the campuses and invested in the State Treasurer’s Short-Term Fund.
- The System’s Treasury Office would work with the State Treasurer’s office to invest the Contingent and Core “classes,” either through current investment funds or strategies managed by the State Treasurer, or through outside investment companies.
- “Deposits” from the campuses would earn a blended rate of return that would be set annually by the Investment Committee in consultation with the System’s financial advisors.

MANAGEMENT OF LONG-TERM DEBT
The System’s current long-term debt management practices, which have been to issue fixed-rate financing and to tie debt service requirements needed from the underlying activity to the debt service schedule of the bonds allocated to a specific capital project, has inhibited flexibility in financing capital projects. With a pooled approach to debt management, the System’s Treasury Office could begin to issue and manage long-term debt on a portfolio basis, taking on variable rate debt and loaning debt proceeds to each campus based on a blended interest rate, to take advantage of the cost savings of variable rate debt in a pooled approach and passing on that savings to the campuses through a blended rate that is lower than would be otherwise obtainable through fixed rates, yet maintaining level debt service payments necessary for budgeting.

The objectives of this structure are:
- Stabilize the System’s cost of capital for current and future capital programs.
- Create predictability in capital cost for budgeting and planning.
- Provide a consistent borrowing rate across institutions, schools, and divisions.
- De-link external and internal debt structures to optimize lending rates and take advantage of optimal market structures.
- Equitable distribution of financing savings including the potential of utilizing low cost short-term financing.

Pooled debt management procedures would be as follows:
- Treasury Office collects all budgeted debt service payments internally into one account which is used to:
- Pay external debt service
- Lend funds internally for projects
- Invest for future capital needs or debt service obligations

- Internal loans are charged the blended rate and structured consistently as level debt service.

The blended debt service rate, which may include a buffer to manage the volatility in the variable rate debt, will be subject to an annual review after debt issuance. The Finance and Administration Committee will set the blended rate, with advice from the System’s debt advisors.

**RISK MANAGEMENT AND ACCOUNTABILITY**

It will be important to manage the risk of implementing these new strategies in operating asset investment and long-term debt management.

With the investment of operating assets, it will be critical to discuss and establish the appropriate levels of both risk and liquidity. A formal investment policy, to be approved by the Finance and Administration Committee of the Board, will be established that will set forth the operating parameters of the central treasury office and each institution to provide clear accountability for operations and set forth the benchmarks against which investment success can be measured.

With portfolio-based management of long-term debt, the System’s debt policy will need to be modified to include operating parameters of the Central Treasury Office and each institution and performance metrics to provide measurable accountability for operations. Additionally, the appropriate level of risk with respect to our “allocation” to variable rate debt, as well as with overall debt levels relative to the System’s and each institution’s financial position and annual operating budgets, will need to be considered.

As a starting point, should the Finance and Administration Committee agree to move forward with these concepts, the following draft policy, which for the investment of operating assets is contingent on the success of the System’s legislative concept to retain interest earnings (HB-2198), is offered as a general framework upon which further policies would be developed.

**BOARD POLICY ON CENTRAL TREASURY**

It is the policy of the Board that operating assets (as defined in policy) of each institution and the Chancellor’s Office be pooled for investment purposes and the System’s Central Treasury Office, working with the Oregon State Treasury and institution and Chancellor’s Office management, be charged with the responsibility and authority to manage the investment of those funds. Furthermore, it is the policy of the Board that the System’s long-term debt (as defined in policy) be managed in a portfolio approach and the System’s Central Treasury Office, working with the Oregon State Treasury, the Department of Administrative Services, and institution and Chancellor’s Office management, be charged with the responsibility and authority to manage the long-term debt portfolio.
Accountability for the Central Treasury function will be measured by reviewing and comparing a separate set of financial statements reporting the financial position and results of the Central Treasury Office against stated goals, as well as measuring investment performance against benchmarks and the System’s resulting cost of capital against established capital cost metrics. These measures will be set forth in an investment policy guiding the investment of operating assets and in the System's debt policy, updated to incorporate these changes.

IMPLEMENTATION DIRECTIVES
The Board directs the Vice Chancellor for Finance and Administration to work with campus administrations to develop policy designed to guide the implementation and management of the investment and debt management functions and to recommend staffing levels and other resources needed to appropriately carry out these functions. The resources needed to carry out these functions will be funded through charges to central investment earnings and debt service charges.

COMMITTEE DISCUSSION:

Controller Green opened the discussion by stating his excitement about the possibilities that could open for the System in the areas of treasury management with the passage of House Bill 2198 and 2199. “This is an opportunity to make government work better and work more efficiently,” he observed. He then explained the materials that were provided regarding this new way of doing business.

To clarify some numbers, Chair Blair asked if Mr. Green was indicating that the pool of money being discussed was around $500 million and that the System could earn between 1 and 2 percent or between $5 and $10 million a year, less the administrative costs required to operate. “That is correct. There are significant opportunities in doing business this way,” Controller Green emphasized.

Currently, long-term debt is managed by issuing bonds based on the projects that are coming up. A portion of a bond sale is allocated to an institution and that institution is bound to make that debt service payment to that allocation of that bond sale. “Basically, the institution is at the whim of the market when those bonds are sold and whatever allocation of bonds that they get, that's the interest rate you get and that's the best service stream you get. Typically, we've issued 20-30 year bonds and there has not been flexibility for campuses to have debt service payment amortization schedules different than that actual underlying debt.”

The portfolio approach in this new design would disconnect the debt service payment, required to be made on the bonds, from what is required to be made by the campus and putting it at a central treasury office. There would be an agreement between the central office and the institution to repay the debt on a schedule and then the central office would be required to repay the bonds on the schedule of the bonds, whatever that is. That allows more flexibility on issuing debt, on timing of those debt issuances, on those structures in order to make those decisions based on the best market structure. It would also allow flexibility for the institutions to repay debt early. Interest earnings are key to this. Repaying debt early without interest
earnings on that money in the meantime, affords the System a real opportunity cost that is worth noting.

Director Lorenzen observed that at the present time, if there is a project and a bond associated with the project, that cost is clearly allocated to the institutions. If they time their project to come on at a time when markets are favorable, they have a favorable expenditure for the interest. “With the blended approach, how will you allocate project costs or interest costs, or debt costs to the institutions associated with the individual projects,” he asked. Mr. Green responded that there would be options in the way in which it is handled and those are the details that will need to be worked out.

It was emphasized several times that having the right policies, procedures, and people were critical to operating in the manner being anticipated in this new process. “Clearly, to implement this structure, we would have to develop an investment policy around this pool of money, a very detailed one, with some specific measurement bases to be able to determine whether or not we're meeting our goals or objectives,” Mr. Green emphasized. “The staffing is key. The right kind of person would probably have ten years of treasury experience at this kind of structure. I would summarize a treasury management in the future this way: in the past, we have made decisions and these are not wrong decisions, but we made decisions on debt and investment management discretely, based on certain sets of factors that influenced those decisions. If we get these authorities from the legislature, we will need to bring these pieces together and think about them every time we make a debt decision.”

Chair Blair agreed that these proposals were exciting. “I think the piece that is not lost on me is the degree of difficulty in getting this thing done. I think that when the legislature acts, as we hope they will, and gives us this authorization, it will have a lot of value for our students, faculties, institutions, and the citizens of Oregon. So, I hope to have that opportunity.” Continuing, he added, “I don't know if anybody from the Committee has a different perspective, or if you think that it is the wrong approach, but it strikes me that this is the right way to go. I'd like to have us take the next step once we have the authorization to go forward,” he concluded.

No dissenting opinions were expressed and Chair Blair closed the discussion cautioning that the amount of time and effort invested in this project should be limited until the Board has the mandate from the legislature. “I'm not sure they're on the bandwagon. But it's absolutely the right thing to do.”

5. **Adjournment**

There being no further business, the meeting adjourned at 9:54 a.m.